AGENDA ITEM K-4

CITY OF LODI
COUNCIL COMMUNICATION

AGENDA TITLE: Direct the City Manager to Research and Recommend a Leveling Mechanism for the Energy Cost Adjustment (ECA) and, in the Interim, to Implement a Maximum Level for the ECA of $0.025 per Kilowatt-hour Beginning in February 2009. (EUD)

MEETING DATE: January 21, 2009

PREPARED BY Electric Utility Director

RECOMMENDED ACTION: Direct the City Manager to research and recommend a leveling mechanism for the Energy Cost Adjustment (ECA) and, in the interim, to implement a maximum "cap" for the ECA of $0.025 per kilowatt-hour beginning in February 2009.

BACKGROUND INFORMATION: In August 2007, the Electric Utility Department began implementation of a monthly Energy Cost Adjustment to ensure that the utility neither under- or over-collected power costs on a current basis. Each month, EUD's power costs are compared with the amount of power costs included in base electric rates ($0.0831 per kilowatt-hour) – the difference becomes the ECA for that month.

In the eighteen months that the ECA has been in effect, the monthly ECA level has ranged from a negative $0.0125 (credit) to a positive $0.0464 (charge). The average has been $0.0157. When the ECA was formulated, it was anticipated that its range would be relatively small with the highest level being in winter months (when overall electric bills are relatively low) of perhaps $0.030 per kilowatt-hour.

For the first sixteen months, the peak ECA level was $0.028 however the ECA has exceeded $0.045 for the past two months (December 2008 and January 2009) in large part due to overall budgeted power costs being higher this fiscal year ($46.7 million) as compared to the prior fiscal year ($42.3 million).

Consequently, it is recommended that a "cap" be implemented for the ECA of $0.025 per kilowatt-hour beginning in February 2009. Power Supply costs that are not recovered in any particular month because of the cap will be rolled over to the next month for inclusion in the ECA calculation. Staff will continue its review of smoothing mechanisms for the ECA for future presentation to the City Council by the City Manager. From a typical electric customer standpoint, the proposed ECA cap will move the recovery of a portion of power supply costs from higher cost winter/summer months into lower bill months in the spring and fall.

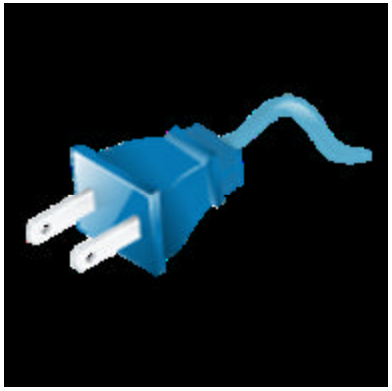
FISCAL IMPACT: The recommended ECA cap is expected to have a relatively nominal (and short term) impact on the utility's cash flow and reserve levels.

FUNDING: Not applicable

George F. Morrow
Electric Utility Director

APPROVED: _____
Blair King, City Manager

Energy Cost Adjustment "ECA"



City Council

January 21, 2009

City of Lodi, California

What is an ECA?

- An ECA is a mechanism to collect/credit purchase power and/or fuel costs on a regular basis
- “ECA”s are called a variety of different names across the country (i.e. FCA, PCA, etc.)
- Timeframes of adjustment run from monthly to quarterly to semi-annually to annually
- The types of charges included in an ECA run the gamut from all power supply costs, variable costs only, fuel only, purchased power only, etc.

Fitch Report "Excerpt"

Liquidity Factor Considerations

Credit Effect	Quick	Slow
Positive	**A** **Best** • Unrestricted cash. • Cash informally pledged. • **Automatic rate adjustment (monthly preferred).** • No automatic rate adjustment (but good dialogue with board). • Surplus fuel reserves.	**B** **Good** • **Automatic adjustment rate (semi annual or longer).** • Cash formally pledged. • Margins substantially above rate covenant.
Neutral/ Weak	**C** **Less Favorable** • Low fuel reserves. • Use of existing commercial paper program. • Drawdown of bank facility.	**D** **Least Favorable** • Operating margins narrowly meeting rate covenant. • **No automatic rate adjustment.** • New long-term deficit financing. • Asset sale.

Liquidity Access

California Public Power Credits Are Adapting To An Evolving Market

Publication date: December 18, 2006

"On the financial side, many utilities that lacked fuel or power cost adjustments five or 10 years ago have now established them. These adjustments allow for quicker and more complete recovery of variable power and fuel supply costs, while at the same time reducing some of the politics that can limit or delay cost recovery. We believe utilities that have yet to implement some version of a variable cost recovery mechanism in their rate structures should certainly consider them, especially those that are gas-dependent, as these mechanisms can help to stabilize financial performance and debt service coverage ratios--two key factors in our credit analysis."

Excerpt

Lodi ECA

- Equals amount of power supply cost different from **8.31 ¢/kwh**
- Energy Cost Adjustment (ECA) updated monthly to reflect actual EUD costs
- Adjustment for variations in actual vs. projected sales on a two month lag
- ECA could reflect a **charge** during periods where costs are higher than "base" level or a **credit** when costs are lower than base level
- ECA identical for all rate classes
- Simple and transparent
- Readily trackable/auditable

Simplified Formula

$$\text{ECA}^* = \frac{\text{Power Costs}}{\text{Sales}} - 8.31¢/\text{kwh}$$

*Plus adjustment for over/under collection two months prior.

ECA Variability

- Generally market power prices higher in summer and winter (hence higher ECA)
- Seattle City Light Exchange
  - Reduces power cost in summer months
  - Increases power cost in winter months

Season	ECA Level
Summer	Low (-1 to +1 ¢/kwh)
Spring/Fall	Medium Range (0 to +1 ¢/kwh)
Winter	High (1¢/kwh to 3¢/kwh)

Issue

- The ECA has exceeded the upper end of the range we anticipated.
- Winter months of December through February the ECA will exceed 3¢/kwh.
- Primary reasons include:
  - Seattle energy payback
  - Increased fixed NCPA plant expenses
  - Higher open market power costs than prior year

Actual ECA to date

($/kwh)

June 2008	0.0060
May	0.0097
Apr	0.0055
Mar	0.0224
Feb	0.0253
Jan 2008	0.0177
Dec	0.0280
Nov	0.0148
Oct	0.0055
Sep	-0.0125
Aug 2007	0.0027

Jul 2008	0.0121
Aug	0.0262
Sept	0.0119
Oct	0.0066
Nov	0.0119
Dec	0.0460
Jan 2009	0.0464

ECA Levels

Actual	Jul 2008	0.0121
	Aug	0.0262
	Sept	0.0119
	Oct	0.0066
	Nov	0.0119
	Dec	0.0460
	Jan 2009	0.0464
Estimated	Feb	0.0474
	Mar	0.0343
	Apr	0.0129
	May	0.0050
	June	-0.0068
	Average	0.0170

Recommendation

- Limit ECA to a level of 2.5¢ per kwh
- Roll any “excess” power costs to subsequent month(s)
- Continue exploring other practical ECA smoothing scenarios
- Return to City Council with a report and recommendations

Questions/Comments?